RESOLUTION NO. 2007-123

Adopted by the Sacramento City Council

February 27, 2007

AMENDING THE FY2006/07 APPROVED BUDGET

BACKGROUND

A. The Midyear Report (Exhibit 3) provides City Council with an update on the current financial condition of the City's FY2006/07 budget.

B. The Midyear Report includes recommendations on adjustments to the Approved FY2006/07 budget necessary to fully implement the City's financial plan for the remainder of the fiscal year.

BASED ON THE FACTS SET FORTH IN THE BACKGROUND, THE CITY COUNCIL RESOLVES AS FOLLOWS:

Section 1. Amend the FY2006/07 adopted budget to include the Summary of Technical Adjustments as detailed on Exhibit 1.

Section 2. Amend the FY2006/07 adopted budget to include reclassifications recommended in the Summary of Reclassification Requests as detailed on Exhibit 2.

Section 3. Provide authority for the Finance Director to adjust Department budgets for the following items:

(1) Release the City Council discretionary account designation of $376,000 into the FY2006/07 budget.

(2) Recognize $1.6 million in revenue and redirect $1.2 million to the General Fund debt service budget and $400,000 to the Department of General Services to fund ongoing operations and maintenance.

(3) Adjust the Fire Department Operations budget at the close of the fiscal year to allow unobligated station expense appropriations (101-250-2532-4414), to be carried forward into the next fiscal year, pursuant to the current fire labor contract.

(4) Transfer $240,000 provided for Electronic Content Management (ECM) from the Information Technology department's operating budget to the ECM Project (AB55).

(5) Add 4.0 Full Time Equivalent (FTE) fully offset positions to the Department of Transportation and increase the department's FY2006/07 revenue and expenditure budget by $174,000.

(6) Add 1.0 FTE and increase the FY2006/07 operating budget by $46,000 in the Parking Fund (412).

(7) Release $1 million from the Advanced Life Support (ALS) designation for allocated costs associated with the Electronic Citywide Accounting and Personnel System (eCAPS) project (AB81).

(8) Transfer department specific costs from the Non-Department budget to the appropriate operating department budgets.

(9) Use Administrative Contingency and unutilized lease appropriations, if available, to adjust the Department of General Services operating budget at year-end, if needed to cover the actual operating costs of City Hall.

(10) Release $205,000 from FY2005/06 carryover to the Public Safety Project (FB32), consistent with Council Resolution 2006-875.

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Exhibit 1 – Summary of Technical Adjustments
Exhibit 2 – Summary of Reclassification Requests
Exhibit 3 – FY2006/07 Midyear Report

Adopted by the City of Sacramento City Council on February 27, 2007 by the following vote:

Ayes: Councilmembers, Cohn, Fong, Hammond, McCarty, Pannell, Sheedy, Tretheway, Waters, and Mayor Fargo.

Noes: None.

Abstain: None.

Absent: None.

Heather Fargo
Mayor, Heather Fargo

Attest: Shirley Concolino
Shirley Concolino, City Clerk

Exhibit 1

SUMMARY OF TECHNICAL ADJUSTMENTS

Department	Fund	FTE	Net $ Change	Description
Code	101	-	200,000	Reduce revenue budget.
Treasurer	101	-	(200,000)	Increase revenue budget.
Planning	101	-	(666,399)	Align CIP/indirect reimbursements and revenue budgets to reflect actual expenditures.
Development Services	101	-	666,399	Align CIP/indirect reimbursements and revenue budgets to reflect actual expenditures.
General Services	101	-	-	Close completed General Government capital projects (CIPs) and transfer project savings to the Intermodal Facility CIP (CF41) , in an amount not to exceed $468,000.
General Services	101	-	-	Adjust Facility Maintenance revenue and expenditure budgets for services provided to the Florin Road Partnership in the amount of $386,000.
Police	101	-	-	Adjust expenditure budgets by $983,657 due to a higher than expected amount of contract work and supply and services expenditures. Offset by higher than expected department revenues.
Transportation	101	-	-	Decrease revenue and expenditure budgets for parking in the amount of $418,479 due to elimination of debt service and construction impacts.
Transportation	101	-	-	Increase revenue and expenditure budgets for concrete maintenance in the amount of $350,000 due to additional demand for sidewalk repairs.
Subtotal - General Fund:			**0**	
Transportation	208	-	294,500	Decrease revenue budget to align with actual revenues.
Transportation	209	-	(1,079,000)	Increase revenue budget to reflect current revenue projections.
Transportation	212	-	(439,630)	Increase the Traffic Congestion Relief revenue budget ($3.810 million) and increase the Streets Overlay Seals program (RH31) expenditure budget ($3.371 million).
Transportation	512	-	177,248	To reduce expenditure budget for Grant funding expired for Swanston Station Village Plan (TE01).
Risk Fund	421	-	(403,000)	Repayment of Loan from the Community Center Fund.
Convention, Culture and Leisure	419	-	403,000	Payment to the Risk Fund for an existing loan.
Convention, Culture and Leisure	419	-	-	Authorize a transfer from fund balance to pay for the Electronic Citywide Accounting and Personnel System (eCAPS) project ($597,000).
Convention, Culture and Leisure	419	-	-	Adjust revenue and expense budgets by $304,000 due to higher than expected number of events.
Convention, Culture and Leisure	417	-		Transfer $146,190 from fund balance to fund eCAPS contribution.
Convention, Culture and Leisure	417	-	-	Adjust revenue and expense budgets by $77,000 to fund dry rot repair at Marina Administration Building.
Utilities	415	(1.0)	-	Adjust the Revenue and expense budget by $1,000,000 for Solid Waste. Transfer 1.0 FTE to Water Fund.
Utilities	413	1.0	-	Adjust FTE to reflect transfer of position from Solid Waste.
Subtotal - Other Funds:			**(1,046,882)**	
TOTAL BUDGET IMPACT:			**(1,046,882)**	

Exhibit 2

SUMMARY OF RECLASSIFICATION REQUESTS All Requests are Subject to HR Approval				
Org. #	**Budgeted Classification**	**Proposed Reclassification**	**FTE**	
Code Enforcement				
4654	Office Supervisor	Customer Service Supervisor	1.00	
4654	Program Analyst	Administrative Officer	1.00	
4654	Typist Clerk II	Customer Service Representative	1.00	
4654	Typist Clerk II	Customer Service Representative	1.00	
4654	Typist Clerk II	Customer Service Representative	1.00	
4654	Typist Clerk III	Customer Service Specialist	1.00	
4655	Typist Clerk II	Customer Service Representative	1.00	
4655	Typist Clerk III	Customer Service Specialist	1.00	
4656	Typist Clerk II	Customer Service Representative	1.00	
4656	Typist Clerk III	Customer Service Specialist	1.00	
4657	Typist Clerk II	Customer Service Representative	1.00	
Convention, Culture and Leisure				
4310	Administrative Officer	Program Manager	1.00	
4370	Account Clerk II	Customer Service Specialist	1.00	
4370	Typist Clerk III	Customer Service Specialist	1.00	
Development Services				
4881	Associate Mechanical Engineer	Assistant Electrical Engineer	1.00	
Economic Development				
4455	Administrative Officer	Program Manager	1.00	
General Services				
3112	Administrative Analyst	Program Specialist	1.00	a
3253	Equipment Body Mechanic II	Equipment Mechanic III	1.00	
3255	Program Analyst	Program Specialist	1.00	
3258	Account Clerk II	Accounting Technician	1.00	
3259	Typist Clerk III	Program Specialist	1.00	
3281	Assistant Architect	Real Property Agent III	1.00	a
3281	Senior Architect	Program Manager	1.00	a
3282	Assistant Architect	Real Property Agent III	1.00	
3283	Typist Clerk III	Administrative Technician	1.00	a
3289	Supervising Architect	Facilities and Real Property Superintendent	1.00	
Human Resources				
1511	Data Systems Technician	Programmer	1.00	
Information Technology (IT)				
1312	IT Project Manager	Senior IT Project Manager	1.00	
1312	Principal Applications Developer	Senior IT Project Manager	1.00	
1320	IT Support Specialist I	Applications Developer	1.00	a

SUMMARY OF RECLASSIFICATION REQUESTS

All Requests are Subject to HR Approval

Org. #	Budgeted Classification	Proposed Reclassification	FTE	
Neighborhood Services				
3611	Neighborhood Services Area Director	Neighborhood Services Area Manager	1.00	
3621	Neighborhood Services Area Director	Neighborhood Services Area Manager	1.00	
3631	Neighborhood Services Area Director	Neighborhood Resources Coord II	1.00	
3631	Secretary	Neighborhood Resources Coord II	1.00	
3641	Neighborhood Services Area Director	Neighborhood Services Department Director	1.00	
Parks and Recreation				
4715	Recreation Superintendent	Recreation Manager	1.00	
4715	Staff Aide (Management)	Recreation Manager	1.00	
4715	Staff Aide (Management)	Recreation Manager	1.00	
Police				
2150	Senior Department Systems Specialist	Information Technology Supervisor	1.00	a
Transportation				
3431	Program Analyst	Program Specialist	1.00	
3482	Parking Enforcement Supervisor	Program Analyst	1.00	a
Utilities				
3325	Utility Construction Coordinator	Program Specialist	1.00	
3333	Engineering Technician III	Program Analyst	1.00	a
3341	Utility Service Inspector	Meter Reading Supervisor	1.00	
3344	Utility Service Inspector	Water Conservation Technician	1.00	
3344	Utility Service Inspector	Water Conservation Technician	1.00	
3344	Utility Service Inspector	Water Conservation Technician	1.00	
3352	Administrative Analyst	Program Analyst	1.00	
3352	General Helper	Staff Aide - Manager	1.00	a
3381	Electrician R2	Instrument Technician	1.00	

a - The proposed reclassification results in a change from a represented position to an unrepresented position.

Exhibit 3

City of Sacramento, California

FY2006/2007 Midyear Report

City of Sacramento
915 I Street, 5th Floor
Sacramento, CA 95814
Phone 916-808-5845 ■ Fax 916-808-5755

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Section 1: Introduction

Overview

The FY2006/07 Midyear Report reflects the City's new Strategic Planning – Strategic Budgeting process implemented with the adoption of the FY2006/07 budget. Whereas past Midyear reports have included extensive discussion related to budget development, this has been shifted to the City Council's annual planning sessions which are focused on the development of policy direction for the preparation of the budget. As a result, the FY2006/07 Midyear Report has been modified to reflect the shift in the planning cycle, and thus, will be used primarily to focus on the status of the current FY2006/07 budget and any budget and staffing adjustments determined to be necessary to implement the City's current year financial plan.

Economic Outlook

The midyear budget evaluation is being made in the context of a slowing local economy and increasing pressure on the City's budget. The City is growing, resulting in the need for staffing and service increases. Unresolved base budget issues have not been funded as they are beyond the current capacity of city revenues. Aging infrastructure is in need of repair and restoration and new infrastructure must be provided. Though the local economy is clearly growing and the region is not in recessionary condition, discretionary tax revenue growth is slowing. There are increasing pressures to increase employee compensation in the areas of both salaries and benefits. **In the shorter run perspective, over the next several years, it is beyond the capacity of the City to fully address all these needs and pressures.** In the Strategic Planning – Strategic Budgeting Process the Mayor and City Council will set priorities determining which needs will be funded and which will not.

In the General Fund the overall status of the budget (deficit, balance, or growth potential) is determined by the relationship between labor costs and discretionary tax revenues. Labor costs, in turn, are determined by staffing levels and overall compensation levels which extend beyond salary to benefits such as health insurance, workers' compensation, pensions, and the retiree medical benefit. Staffing levels and compensation levels largely, but not entirely, are determined by discretionary actions of the Mayor and City Council and the collective bargaining process. Market conditions, the performance of retirement plan investments, and accounting standards may also influence compensation costs. Economic conditions and the nature of development within the City determine levels of discretionary tax revenues.

The major difficulty in budget development and decision making is that there is little relationship between overall labor costs and tax revenue. While increases in overall

compensation levels are driven by multi-year labor contracts with employee organizations, there is no guarantee that the performance of the economy and real estate market will generate sufficient revenue growth to meet these increasing costs.

Although there is new development in the planning stages which could increase the City's revenue base, these projects are years from being completed and generating new revenues. Further, the General Plan Update process and the Police and Fire Departments Master-planning efforts will provide the City with additional information related to future City growth and resource needs.

As a result, consistent with Council's direction at the January 9th planning session, we are looking at a variety of options to expand the City's revenue capacity. To address this situation, the Economic Development Department is in the process of developing a plan that will ultimately bolster sales tax within the City in order to grow overall revenues. The Economic Development Department will be conducting a special Council planning workshop on this issue in March. In addition, we will be discussing these, and other strategies, during the FY2007/08 budget development process.

Section 2: General Fund Financial Report

Revenue Perspective

Revenue growth from FY2002/03 through FY2004/05 exceeded the growth in expenditures needed to maintain the base budget. This revenue growth gave the Mayor and City Council the capacity to close a structural budget gap, enhance high priority programs, build up budgetary reserves, and allocate fund balances to one-time uses. The City has witnessed very strong growth in discretionary tax revenues: property taxes, sales tax, and utility user tax (UUT).

The revenue growth, however, is now beginning to slow. Revenues are not decreasing; rather, revenue growth is slowing. It is important to put the need for revenue growth into perspective; the General Fund requires approximately $13 to $14 million in new revenues to maintain staffing and service levels from fiscal year to fiscal year.

The major factor in the extraordinary revenue growth in recent years, and now the slowing revenue growth that is the trend for the next few years, is the result of the local real estate market. In recent years the sales of both new and existing homes and the market values of residential properties reached record levels. The extraordinary performance of the real estate market also has had positive impacts on sales tax and utility tax growth. However, because the City's sales and property taxes per capita are lower than other cities in the region, the City has become heavily reliant on UUT to fund base budget requirements.

Economic booms such as this real estate market performance, however, are not sustainable. In the past year and a half the number of both new homes and existing homes being sold has declined. The market value of residential properties is stagnant. These changes have combined to lower property tax, sales tax, and UUT growth.

In the current fiscal year, overall tax revenue collections are tracking very close to the budgetary estimates, and there is no need to make midyear adjustments. The major growth assumptions for the current year are:

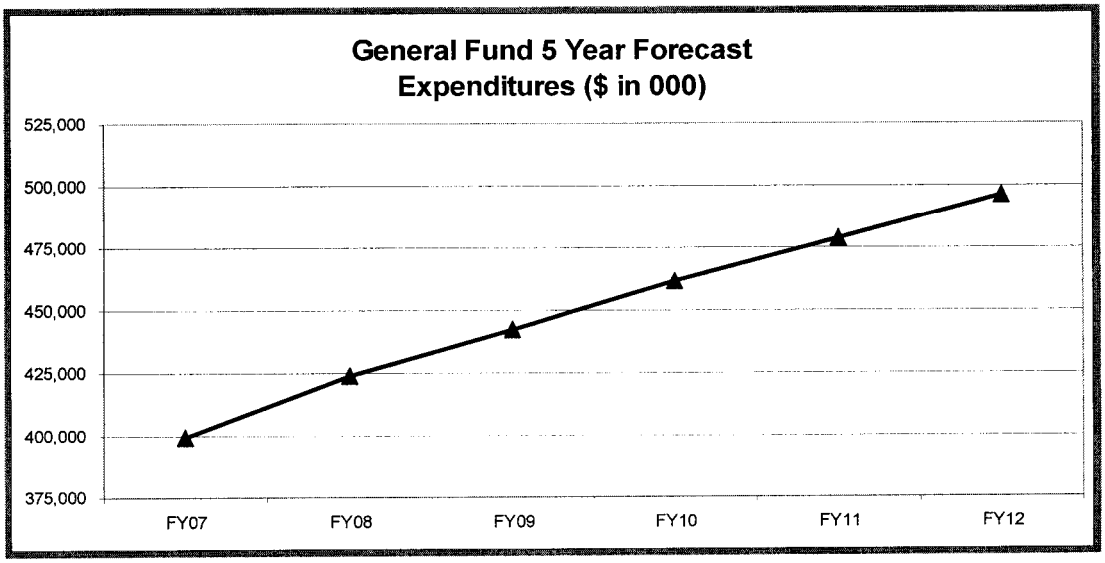
Main Roll Property Tax	15 % growth
Sales Tax	5 % growth
UUT	4 % growth
Transfer and Supplemental Tax	48 % reduction

At this point in the year, it appears there will be neither significant revenue shortfalls nor over-collections.

Five Year Forecast

The five year forecast of the General fund is an important fiscal planning tool. Under the sustainable budget policy of the Mayor and City Council, proposed fiscal actions are evaluated in a longer term, rather than a short term, context. The five year forecast is based on the current budget and projects future expenditures, revenues, and other funding sources over a multi-year horizon. Given that nearly three-quarters of expenditures are labor costs and nearly three-quarters of all funding is tax revenues, estimating future changes in these categories is the focus of the forecast. All other expenditures and funding sources are also considered. On the expenditure side, the approval of multi-year agreements with the unions representing city employees allows for increased accuracy of the multi-year projections. However, as mentioned above, it is more difficult to project future changes in revenues with the same high level of accuracy, particularly in the out years of the five year forecast. The three major tax revenues are property taxes, sales tax, and utility user tax. These taxes are derived from different types of economic activity within the City.

As was outlined at the January 9, 2007 City Council Planning Session, the five year forecast of the General Fund presents only limited capacity for growth after base budget commitments, such as labor agreements, are fully funded. The five year forecast of the General Fund includes slowing the projected property tax growth to 10 percent in FY2007/08 and 6 percent in FY2008/09, constant sales tax and UUT growth, and stable levels of Transfer and Supplemental taxes. The revenue estimates and long term assumptions are examined and reevaluated quarterly. The following graph illustrates the five year forecast of the current base budget expenditures and high priority Council initiatives:



As has been discussed previously, this base budget forecast indicates that ongoing expenditures exceed ongoing revenues over the next four fiscal years. It is estimated that growth in revenues will exceed expenditures closing this gap in the last year of the five year period. Because the overall trend is positive, it is appropriate to use one-time financial resources such as fund balance and reserves to close the gap and to maintain current staffing and service levels. However, this situation provides minimal capacity to address identified Council priorities.

Budget Status

The FY2006/07 Approved Budget was implemented within the context of the Mayor and City Council's policy of long term fiscal sustainability. Included in the budget were several new programs and strategies to address the City's growing needs within the available resources. These strategies included the conversion of funds previously utilized for overtime costs into new full-time equivalent positions (FTE) and the implementation of new programs funded by revenue generated by the FTE associated with those programs.

As a result of the midyear review process, we have identified four areas in the FY2006/07 budget that are presenting administrative challenges that we will be monitoring for the remainder of the fiscal year and working closely with the responsible departments to make adjustments to programs and operations to meet budget goals. Following is a brief description of each of the identified issues and strategies to address these issues for the remainder of the fiscal year. In order to ensure that resources are available to address any outstanding issues at the close of the fiscal year, staff is recommending that the FY2005/06 department carryover funds identified in the FY2005/06 Comprehensive Annual Financial Report (CAFR) be set aside for this purpose. This recommendation is outlined further in the Use of Carryover section below.

Fire Department

During the development of the current budget the Fire Department outlined several challenges they faced in implementing their fire suppression operations. The most compelling issue was that the Fire Department had been working under mandatory overtime conditions for over 12 months. This not only resulted in increased overtime costs to fill the necessary operational shifts, but also affected morale. In an effort to reduce mandatory overtime and boost employee morale, Fire Department management designed a strategy implemented in the current year budget that included the addition of 12 firefighters and a decrease in the overtime budget.

Fire Department management was committed to this plan and the operational changes that would need to be implemented in order to achieve the savings necessary to be successful. During the midyear review process, it became apparent that this plan took significantly longer than planned to fill the vacancies necessary to impact overtime expenses. In fact, because the first Fire Academy class after the implementation of this new model did not graduate until late December 2006, mandatory overtime did not end until that time. This has resulted in significantly higher than anticipated overtime costs. In addition, higher than anticipated payouts for sick/vacation leave and mandatory staffing has limited the Fire Department's ability to meet standard City labor savings.

In response to this situation the Fire Department is implementing operational changes to minimize the variance between budgeted expenditures and actual year end results. To this end, the Fire Department: is continuing with fundamental training associated with filling suppression FTE and State operational mandates but has ceased all other training; has identified major expenditures to be deferred; and reviewed and made adjustments to administrative/special detail assignments. The Fire Department will continue to scrutinize labor and other costs to reduce expenditures.

Development Services Department (DSD)

Development Services revenue is highly dependent on construction and development market conditions. For most department revenue categories, significant variations from budget are not anticipated. However, it remains to be seen whether fluctuations in Downtown and North Natomas construction activity will impact the building and plan check fee categories. Therefore, revenues are being closely monitored and the department is prepared to implement operational adjustments as necessary to remain within budget.

One example of operational adjustments that has already been made in the department to reflect the sensitivity to the status of revenues is the implementation of the Matrix program. In July 2006 the City Council authorized an increase of 32 FTE in development-related departments to support the MATRIX business model. The addition

of these positions was contingent upon the receipt of anticipated revenues. Currently, development revenues only support the addition of 12 of the 32 approved FTE. The remaining 20 FTE will be added once it can be demonstrated that development revenues can be sustained.

In an ongoing effort to ensure that development revenues reflect City costs to deliver development services, the department is in the process of reviewing the structure of development fees. It is anticipated that the study will be completed in early April and presented to Council in early May. Currently, development fees have not kept pace with the costs to deliver services and thus, have been subsidized by the General Fund. This study of the development review functions will demonstrate the actual cost to provide those services necessary to process development applications.

Code Enforcement

In FY2005/06 the Code Enforcement Department was established as a stand-alone department. Labor costs increased with additional staff and the revenue budget was increased to reflect new revenues associated with code enforcement activities. In the current FY2006/07 budget, new programs were added to Code Enforcement including taxicab enforcement and the Rental Housing Inspection Pilot Program. Both programs included the addition of FTE to implement the program and the assumption of associated revenue that would be generated through enforcement efforts to pay for the additional staff.
What is notable for the City is that these programs have been more successful than ever anticipated. However, while compliance marks success for the Code Enforcement Department, positive compliance in both programs has resulted in fewer citations, penalties, and notices and orders issued. As a result, less revenue was generated than expected for this fiscal year. The economy and the housing market also have an impact on the liens that are placed on property and the rate of revenue collection. These factors should be taken into consideration for the continuation or addition of new programs, since continued compliance affects the amount of revenue that is generated and increases reliance on the General Fund for the continued implementation of these programs.

An additional impact to the Code Enforcement budget is the increased level of vehicle abatement activity. The cost of towing vehicles has continued to climb beyond the expected budget for these services. In addition, Code Enforcement has become a 24/7 operation. Building inspectors respond 24 hours a day as requested to assist the Police or Fire Departments and emergency response for incidents involving damaged structures; this service is provided on an overtime basis. Costs associated with this activity have increased since 1998 when this program was established. The department is implementing efforts to reduce current year expenditures to minimize the variance between budgeted expenditures and actual year end results

General Services

The Department of General Services is responsible for acquiring, constructing, maintaining and operating City facilities. In the last 20 months, the City has acquired/added approximately 342,000 square feet of new space including: 911 Dispatch Center (significantly larger than the prior center), North Area Corporation Yard, new and expanded Fire station facilities (5, 20, and 30) as well as the recent acquisitions of 300 Richards Boulevard and the Historic Railyards Depot Building.

In addition, the full cost for the operation of new City Hall has not yet been addressed in the Department's base budget. The City has also dramatically increased park space over the last few years, which has resulted in 50 new booster pumps that require ongoing plumbing and electrical maintenance support, contributing to the need for additional maintenance beyond those associated with new buildings. In addition, overall services and supply costs have increased steadily over the last several years without corresponding adjustments in budgeted funding for these costs.

The added square footage and cost increases without an adequate budgetary adjustment has led to a gap in the Department of General Services facilities budget.

In an effort to address the significant cost pressures related to bringing new facilities online, staff is recommending that the department's operating budget be adjusted to include funding for operations and maintenance of the Richards Boulevard facility. Staff recommends that any unused portion of this funding be redirected in the current year to City Hall issues. Staff is also recommending that initial Depot related costs of $468,000 be funded with savings from completed and closed facility CIPs. In addition, the resolution includes a technical adjustment to recognize revenue and expenses related to work completed by General Services staff for the Florin Road Partnership.

Finally, consistent with the past two fiscal years, the midyear resolution includes authority for the City Manager to use Administrative Contingency, if available and unutilized lease appropriations to adjust department operating budgets at year-end, if needed for the actual energy and operating costs of these new facilities.

Budget staff will continue to work with General Service's staff to address the budget impacts related to facility growth. In addition, staff will report back to Council during the FY2007/08 budget process on adjustments needed to support facility operations and maintenance due to growth.

Conclusion

We will continue to monitor budgets through the coming months. As noted above, in order to ensure that resources are available to address any outstanding issues at the close of the fiscal year, staff is recommending that the FY2005/06 department carryover

funds set aside in the FY2005/06 Comprehensive Annual Financial Report (CAFR) is set aside for this purpose.

General Fund Budget Adjustments

Minimal midyear budget and staffing adjustments in the General Fund are being recommended for Mayor and Council approval. These address critical needs and are reflective of Council direction. The recommended adjustments include:

- Technical adjustments as detailed on Exhibit 1.
- Provide authority for the Finance Director to adjust the budget by moving department specific costs from the Non-Department budget to the appropriate operating department budgets (i.e. labor costs related to contract implementation for City non-profit partners, facility lease costs and information technology licensing costs).
- Release the City Council Account designation in the FY2005/06 CAFR into the FY2006/07 budget.
- Recognize $1.6 million in revenue in the Non-Department budget to reflect the State's FY2006/07 budget which provided an additional year of reimbursement for the City's costs related to jail booking. Increase the General Fund debt service expense budget by $1.2 million to fund debt service payments associated with the purchase of the 300 Richards Boulevard facility. Increase the Department of General Services operating budget by $400,000 to fund the ongoing operations and maintenance costs associated with the new facility.
- Provide authority for the Finance Director to adjust the Fire Department Operations budget (101-250-2532-4414) at the close of the fiscal year to allow unobligated station expense appropriations to be carried forward into the next fiscal year. This adjustment is pursuant to the current fire labor contract.
- Transfer funding provided to the Information Technology Department for the Electronic Content Management (ECM) project from the department's operating budget to AB55, the CIP for ECM.
- Release $1 million from the Advanced Life Support designation for allocated costs associated with the Electronic Citywide Accounting and Personnel System (eCAPS) project.
- Increase staffing in the Department of Transportation by 4.0 FTE and augment the FY2006/07 operating budget by $174,000 for the partial year cost of the FTE and a portion of the equipment needed. These positions will respond to the growing demand for traffic control management within the City. These positions

will be 100% offset. The remainder of the one-time equipment needs will be addressed in the FY2007/08 budget process.

Reclassifications

Consistent with City Council direction, staff is recommending the reorganization of the Neighborhood Services Department (NSD). Since the formation of NSD in 1993, the "area teams" concept has changed to include resources to sustain operations and resources to the community. In addition, Code Enforcement became its own Department in 2005. This created an opportunity to reorganize the department to reduce management, increase field operations, and compliment a "team" approach to support each Council District. The focus is also on a "one" department concept to ensure consistency, uniformity and accountability of service delivery. In order to accomplish this reorganization, NSD has reclassified several positions at no additional cost to the Department and are in the Reclassification Summary in Exhibit 2.

In addition, several other departments have identified a number of positions that need to be reclassified to address department restructuring/organizational changes. These reclassifications are also included in the Reclassification Summary in Exhibit 2.

Use of Carryover

Pursuant to the FY2005/06 Comprehensive Annual Financial Report (CAFR), Council placed $4.1 million of departmental savings in a designation for future expenditures. Staff is recommending Council authorize the release of $205,000 pursuant to Resolution 2006-875 to replenish the Public Safety Project (FB32) as those funds were advanced from the CIP in order to award the contract for the citywide IT generator project. Staff recommends that Council defer further action on the remaining $3.895 million in order to have those funds available at the end of the fiscal year to address any variance from expected year end results.

Section 3: Other Funds Budget Adjustments

Revenues and expenses of the Enterprise Funds are generally consistent with existing plans and only minor adjustments are necessary to fully implement Council's prior direction. Further action will be required for FY2007/08 to ensure that revenues are at appropriate levels to accommodate the costs of the labor agreements and ongoing cost of service.

This section provides an overview of the recommended midyear adjustments to programs funded from funds other than the General Fund. There are several technical budget adjustments which require Mayor and City Council approval and are detailed in Exhibit 1.

Reclassifications

The Utilities Department has identified a number of positions that need to be reclassified as part of a department wide organizational restructuring. The resulting reorganization is necessary in order to accommodate changes in regulatory requirements, provide career paths, and increase department efficiencies. These reclassifications are included in the Reclassification Summary in Exhibit 2.

Other Fund Budget Adjustments

Parking Fund (412)

Add 1.0 FTE Maintenance Worker II to address critical workload associated with acquisition of the Amtrak depot parking facilities. This position will be funded with revenues generated by off-street parking activities.

Solid Waste Fund (415)

The Solid Waste Division started the FY2006/07 with a deficit fund balance in the amount of $2.212 million. Part of the reason for the negative beginning fund balance was due to timing on the closure of $1.530 million in unspent purchase orders that were not processed to realize the decrease in FY2005/06 obligations. The closure of these purchase orders occurred in FY2006/07. The Division has identified two other significant adjustments to fix the remaining deficit of $682,000: (1) anticipated savings of $360,000 on Solid Waste projects and (2) salary savings of $322,000 due to vacancies and overtime reductions as a result of organizational efficiencies.

The Solid Waste Division is anticipating an increase of revenues of $1 million, primarily through user fee charges. The increase in revenues will help to offset an anticipated increase in costs of $1 million due to hauling fees, vehicle fuel and additional waste containers that are growth related.

Marina Fund (417)

Increase expense budget by $77,000 to repair dry rot damage at the Marina Administration Building. Increase revenues by $77,000 as a result of increased revenues from berth fees.

Transfer $146,190 from the fund balance to fund the Marina Fund's allocated costs of the eCAPS project.

Convention Center Fund (419)

Transfer $597,260 from the fund balance to fund the Convention Center Fund's allocated costs of the eCAPS project. Transfer $402,740 from fund balance to accelerate the repayment of the loan from the Risk Fund.

Section 4: Pending Fiscal Issues

There are a number of fiscal issues that have been previously discussed by the Council that will need to be considered as we move forward into the development of the FY2007/08 budget. These issues are outlined below.

Focus Area Funding

During the FY2006/07 budget development process, Council considered the allocation of $7.5 million to five focus areas through the Strategic Planning-Strategic Budgeting process: Public Safety, Economic Development, Culture and Entertainment, Sustainability and Livability, and Safe and Affordable Housing. During the budget hearing, Council approved the allocation of $5.5 million in a combination of one-time and ongoing costs. Through subsequent Council action an additional $900,000 has been allocated. This leaves a remaining balance of $1.1 million for future consideration and allocation. Allocating these funds to any on-going program or function will only increase the budget gaps in future years. This funding, and any additional resources, will be brought back to Council for consideration during the FY2007/08 budget process.

Labor Relations Issues

At the Council's January 9th planning session and with a subsequent follow-up Council report to Council, Council has provided direction to include the addition of 911 dispatchers, the conversion of park maintenance contracts to full-time staffing and the launch of a City 311 program in the development of the FY2007/08 budget.

In addition to these issues, Labor Relations has determined that the Police Department is having an increasingly difficult time recruiting and retaining qualified employees in the Communication Center, Records Division and Forensic Identification Sections of the department. Specifically, the positions of Dispatchers, Records Assistants, and ID Technicians. These divisions have lost large numbers of seasoned employees to other agencies that offer lighter workload and enhanced compensation packages. As a result, remaining employees are working mandatory overtime and struggling to maintain service levels. To address these issues, increases to salaries, educational incentives and shift differentials may be considered. It is estimated that these increases would cost an additional $1.9 million ongoing in FY2007/08.

Dispatchers	$ 1,130,000

ID Technicians	318,000
Records Clerk	508,000
Total	**$ 1,956,000**

The Budget Office and Labor Relations are working with the Police Department to analyze these issues and understand the related overtime costs. We believe that there may be an opportunity to address some of these issues with management/operational adjustments and will provide Council with additional information as it becomes available.

Long-Term Fiscal Issues

During the budget hearings for FY2006/07 the Mayor and City Council were presented information regarding three longer term issues which represented potential fiscal risks. These long term issues are growing in significance and potential fiscal impact. They are beginning to compete for the limited discretionary tax base with service enhancements and employee compensation increases. The City's fiscal position may also be impacted by actions of other governmental entities – local, the State, and the Federal Government. A discussion of each of these issues follows below.

Utility Users Tax (UUT)

The UUT is the third largest source of discretionary tax revenue in the General Fund. The tax applies to electrical, natural gas, telephone (land line & cellular), and cable television services. There are threats to the telephone portion of the UUT, and there are market changes which will affect the cable television portion of the UUT. The City's UUT had been linked to a federal excise tax which is no longer enforced and is being repealed. Earlier in the fiscal year, the Mayor and City Council approved changes to the UUT ordinance severing the link to the federal excise tax; this approach to resolving the issue may be challenged. The cable television market is being opened to new providers and satellite television providers, to which the UUT does not apply, that are gaining market shares. As a result of these changes in the marketplace and regulatory environment, the overall impact on UUT revenues is uncertain. Loss of UUT for telephones services would have a $21.3 million impact.

The City is heavily reliant on UUT revenues as our sales tax base is not as strong as other cities in the region. To address this situation, the Economic Development Department is in the process of developing a plan that will ultimately bolster sales tax within the City, in order to grow overall revenues and ultimately reduce our reliance on UUT.

Sacramento City Employee Retirement System (SCERS)

Until 1977 the City provided its own stand-alone retirement plan for City employees. SCERS is a closed retirement plan. In 1977 the City shifted its retirement benefit to CalPERS, and all employees hired since that date are not members of SCERS. There are approximately 1,150 retirees covered by SCERS and 120 active employees covered by the plan. All other retirees and active employees are covered under CalPERS.

The City has not made an employer contribution to SCERS since 1992; however, active employees have been making their employee contribution. The City Treasurer is responsible for investing and managing the accumulated employee and employer contributions until the funds are paid out to the retirees.

The City Treasurer has stated that SCERS is a "closed" retirement plan (i.e. no-new-entrants to the plan) and presently $15 million in investment income is earned by the plan and approximately $1 million comes from the plan member's contributions. Because SCERS is a closed retirement system, the investment of trust funds must be more conservative than is the case with an open system such as CalPERS.

In recent years, the investment earnings assumptions for SCERS had been lowered in recognition of the changing investment dynamic. The current SCERS investment return is approximately 240 basis points to 250 basis points less than other retirement plans that are not "closed" to new members. Last year the AIFM Board adjusted an actuarial rate of return to 6.5%. This has created the need to make a $3.4 million annual employer contribution to SCERS in FY2007/08 from all funds. The actual performance of investments is compared to the assumed performance in the annual actuarial study of SCERS. The Treasurer has reported that the SCERS plan achieved a return of 7.5% for the first six month of FY 2007 and 10.7% for the 12 months ending December 31, 2006. Additionally, the Treasurer believes the plan will earn the actuarial earning assumption rate of 6.5% and will not require additional contributions larger than $3.4 million and may result in future credits.

The difference between the assumed and actual performance will impact the amount of the employer contribution to the plan. Other actuarial assumptions are also reviewed and changed when warranted. The annual employer contribution will change over time, but it is not likely to be reduced to zero in the foreseeable future.

It is important to note that the real issue is not that the City has to make an employer contribution after 15 years; rather, it is remarkable that the City has not had to make a contribution since to this retirement plan since 1992.

New Accounting Standard for Retirement Medical Benefits

Financial reporting changes in how State and Local Government employers are required to report the cost of retiree medical benefits represents a very serious fiscal risk and threat.

The City provides a medical insurance subsidy to retirees who meet certain longevity standards. The City has been budgeting and reporting the cost of the retiree medical benefit on a pay-as-you-go basis. Only the regular payments to the vested retirees are included in the Budget reported in the City's Financial Statements. This contrasts with the pension benefit which is included in the Budget and the Financial Statement on a

different basis. With pensions, the long-term costs of providing the benefit for vested retirees and employees is calculated and the annual cost of fully providing the benefit is determined and included in the Budget and reported in the Financial Statements.

The Governmental Accounting Standards Board (GASB) has set new standards which will go into effect for Fiscal Year 2007/08 and will impact how the City must report the long term cost of providing the retiree medical benefit. The City will now have to report the long term costs of providing the retiree medical benefit on the same basis as the pension benefit, but the City will not necessarily have to fully fund the retiree medical benefit.

The new standard will go into effect in Fiscal Year 2007/08 and requires reporting of the cost of the retiree medical benefit on an accrued actuarial basis. The cost of providing the benefit to all vested retirees and employees will have to be included in balance sheets included in the annual Financial Statement. The City will also have to disclose a plan to fund the benefit. Continuing with pay-as-you-go qualifies as a plan.

This is a nationwide issue, and all state and local governmental will have to conform to the new reporting standard.

The long-term dollar cost of providing the benefit will measure in the hundreds of millions. The annual cost of funding the retiree medical benefit on the same basis as pension benefit will measure in the tens of millions. The current pay-as-you-go cost in the Budget is approximately $6.3 million and has increased from $4.3 million over the past four years.

While the City may continue funding the retiree medical benefit on a pay-as-you-go basis, continuing with the status quo practice represents a significant fiscal risk to the City. The credit rating agencies have indicated that failing to fully fund the retiree medical benefit on an accrued actuarial basis will be an adverse factor in determining credit ratings. Should the City's credit rating be downgraded significantly the costs of borrowing would become prohibitive and the City may find it impossible to borrow. This would bring most development with the City to a halt.

This risk is made more real by the fact that some governmental agencies are funding the benefit on an accrued actuarial basis, including agencies in California. New cities, such as Citrus Heights, Rancho Cordova, and Elk Grove do not have large numbers of retirees or long term employees, so their long term liabilities are proportionally much lower than the City's. Some agencies have borrowed to pre-fund the benefit and are including the debt service in their budgets. Other agencies have the capacity to divert operating revenues to this new need. In the case of the City, however, pre-funding the benefit presents an extraordinarily difficult fiscal challenge. And in the longer run, the City may not have a real choice

A City working group has been formed to gather facts and explore the City's options for dealing with the new accounting standard. The working group consists of representatives of the Finance Department, Human Resources, Labor Relations, and the Treasurer. Once basic facts are gathered we plan to invite other stakeholders to join in examining the problem, including employee unions and retiree representatives.

The Mayor and Council will receive periodic updates on the status of the issue and the magnitude of potential fiscal impacts before any decision is required.

Other Governmental Actions

The City's expenditure needs and revenue base may be impacted by the actions of other governmental entities; actions that the City will have little ability to influence. Sacramento County is facing serious budgetary problems and has acknowledged these problems. When the County is forced to make budget reductions on countywide programs, these reductions disproportionately affect City residents. Lower levels of mental heath, public health, homeless, human assistance, and probation services have impacts on City public safety and other services. According to the latest County budget update, current County service levels should be maintained in Fiscal Year 2007/08; in future years, however, the County will be facing serious budget problems as costs grow and revenues, particularly unincorporated area revenues, are stagnant.

State and Federal actions may also impact the City. The State of California has a much publicized structural budget gap which will have to be closed at some point. Cities and other forms of local government can be impacted notwithstanding the voter's approval of Proposition IA. The Federal Government also has a significant structural gap between expenditure and revenues which is made up by borrowing. Should Congress and the President begin to close that gap, federally funded local programs may be at risk. Reducing federal expenditures may also impact the overall economy.